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Before the
FEDERAL COMMUNICATION COMMISSION
Washington, D.C. 20554

In the Matter of:	)	
	)	
Implementation of Sections of the	)	
Cable Television Consumer	)	MM Docket No. 92-266
Protection and Competition Act of	)	
1992; Fifth Notice of Proposed	)	
Rulemaking	)	
	)	
Rate Regulation	)	

COMMENTS OF DISCOVERY COMMUNICATIONS, INC.

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To: The Commission

COMMENTS OF DISCOVERY COMMUNICATIONS, INC.

Discovery Communications, Inc. ("Discovery"), by its attorneys, hereby submits its comments on the Commission's Second Order on Reconsideration, Fourth Report and Order, and Fifth Notice of Proposed Rulemaking in the above-captioned proceeding.[1] As the owner and operator of an established cable network -- The Discovery Channel -- as well as an emerging network -- The Learning Channel -- Discovery's interest will be directly affected by the resolution of both the specific programming issues raised in the Notice and the more general programming issues on which senior FCC officials publicly have solicited comment. The proper resolution of these outstanding programming issues is critical to the public interest, as the essence of cable service is programming.

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[1] MM Docket No. 92-266, FCC 94-48 (released March 30, 1994) ("Second Order on Reconsideration," "Fourth Report" or "Notice").

I. INTRODUCTION AND SUMMARY

Discovery is a provider of innovative and informative cable program services. Since its founding in 1985, The Discovery Channel has evolved into one of America's most appreciated cable networks with millions of loyal viewers. In 1991, Discovery -- recognizing the need for a channel dedicated to educating viewers of all ages, and especially preschoolers -- added to its offerings The Learning Channel. This network features not only high-quality educational programs on subjects such as history, science, archeology and anthropology, but also six hours a day of award-winning programming for preschoolers without commercials. The mission of both channels is to educate and entertain television viewers. Hence, Discovery's offerings are examples of the high-quality, diverse programming produced by the unfettered operation of the cable programming marketplace. Cf. H.R. Rep. No. 628, 102d Cong., 2d Sess. 86 (1992) ("since cable rates were deregulated in 1986 there has been an increase in the quality and diversity of cable programming.").

In the Fourth Report, the Commission adopted "going-forward" rules designed to restore the marketplace incentives for operator investment in the programming industry that existed prior to regulation. The rules permit operators a 7.5% mark-up on incremental programming expenses, and a nominal "network cost adjustment" of one or two pennies when a channel is added to a regulated tier. Unfortunately, however, the compensation levels permitted operators under the going-forward rules are simply inadequate to achieve the Commission's objective.

In apparent recognition of this fact, the Notice seeks comment on whether the FCC's goals of "encouraging infrastructure development and growth of programming" would be served by increasing the network cost adjustment to provide greater compensation to operators and whether such an action would meet congressional and FCC goals of "encouraging infrastructure development and growth of programming." Notice at ¶ 256. Discovery, as a programmer operating networks with divergent economics and positions in the cable programming marketplace, submits these comments to urge the Commission to enhance significantly the incentives for the continued growth of programming -- a goal that properly includes both the launch of new networks and the sustained operator support of existing networks -- but in such a way that treats various classes of cable networks in an evenhanded fashion. Such an approach will serve the public interest by allowing subscriber needs and preferences, rather than regulations, to dictate the economic viability of a network. Specifically, Discovery herein recommends that the Commission adopt a flat fee mark-up for additional channels added to a regulated tier in conjunction with an increased percentage mark-up on other incidental programming expenses.

Discovery also urges the FCC to address several issues vital to the continued viability of relatively low-fee, high-quality programming. As Discovery has previously informed the Commission, carriage of a program service on a highly-penetrated tier is critical to the success of an advertiser-supported cable network that offers subscribers high-quality programming at a relatively low cost. To balance this interest with operators' need for flexibility, Discovery supports the NCTA proposal for operators' a la carte practices, which,

as Discovery understands it, would allow an operator to migrate a fixed number of channels on a regulated tier to a la carte status without regulatory repercussions. The FCC should supplement its existing rules, moreover, to specify guidelines allowing operators to safely "retier" cable networks from a la carte offerings to a regulated tier without thereby incurring liability and without fear of violating the negative option rule. These guidelines will serve the public interest, consistent with the Act, by ensuring that subscribers continue to have access to networks inexpensively priced because they are supported by advertising revenue streams.

Further, the Commission should modify its rule governing the scope of review triggered by a subscriber complaint for the cable programming services tier. The FCC has ruled that complaints directed at rate increases caused by external cost pass-throughs -- such as the addition of a new channel or increased programming expenses -- open an operator's presumptively reasonable entire rate structure to review. This ruling will not only cast a cloud of uncertainty over operators' finances, but also make operators extremely reluctant to support programmer's efforts to launch new channels and improve existing programming fare. Accordingly, Discovery recommends that the FCC limit the scope of review in such instances to the amount of the rate increase caused by the pass-through.

II. TO BETTER SERVE THE PUBLIC INTEREST IN A GROWING PROGRAMMING MARKETPLACE, THE COMMISSION SHOULD INCREASE SUBSTANTIALLY THE COMPENSATION ALLOWED UNDER THE GOING-FORWARD RULES IN A MANNER THAT TREATS PROGRAMMERS EQUALLY

Discovery urges the FCC to increase the incentives for cable operators to invest in cable programming by focusing not only on an operator's return when adding channels, but also its return on programming expenses for already-carried program services. It is only by addressing operator investment across the full spectrum of the marketplace that the Commission can succeed in resurrecting more fully the robust state of the pre-regulation programming marketplace and, in turn, attain its asserted goal of ensuring the continued growth of high-quality programming at a reasonable cost. If the Commission were to enhance the incentives for investment in new programming without also increasing the mark-up for existing networks, the public interest would be disserved as regulations, rather than subscriber preferences, would drive the selection of programming available to the viewing public.

As currently drafted, the Commission's going-forward rules are woefully insufficient to encourage operators to continue their vital partnership with programmers in the launch and promotion of new cable networks. The Commission in the Fourth Report recognized that its rules failed adequately to account for the addition of new channels to regulated cable service, and accordingly determined that its going-forward methodology must "provide sufficient

incentives for cable operators to invest in continued growth of cable television service."[2] Discovery respectfully submits, however, that the ensuing FCC action in the Fourth Report -- while alleviating some of the regulatory issues surrounding the launch of new services -- has failed to achieve the desired objective. Discovery's experience makes clear that the one or two cents compensation and 7.5% mark-up offered to operators for adding channels under the FCC's rules is simply not enough.

Indeed, Discovery's difficulties in gaining operators' support for the widespread carriage of The Learning Channel are illustrative of the continuing problems created for vendors of new programming by the FCC's rate regulations. Since the benchmark/price cap regime went into effect, operators have been very reluctant to add The Learning Channel to their system, even though some of the same operators were actively interested in carrying the network prior to the rate regulations. Those operators that showed continued interest were primarily desirous of adding The Learning Channel to their systems on an unregulated a la carte basis.[3] While Discovery had hoped that the going-forward rules would cure these problems by restoring incentives for programming investment, operators' continued

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[2] First Order on Reconsideration, Second Report and Order, and Third Notice of Proposed Rulemaking, 9 FCC Rcd 1164, 1242 (1993) ("First Order on Reconsideration").

[3] Making matters worse for new networks, the must-carry provisions of the 1992 Cable Act caused operators to cede much of the scant channel capacity available for new cable networks to mandatory carriage of broadcast television stations. Operators were thus largely stripped of the ability, as well as the incentive, to add The Learning Channel, which is the kind of diverse, high quality, cable network that Congress endorsed in adopting its policy of expanding cable programming under the 1992 Act. See 1992 Cable Act at §§ 2(b)(1), 2(b)(3); H.R. Rep. No. 628, 102d Cong., 2d Sess. 86 (1992) ("since cable rates were deregulated in 1986 there has been an increase in the quality and diversity of cable programming.").

reluctance to add the network to a regulated tier of service now makes it apparent that the modest incentives are not sufficient.

Discovery therefore urges the Commission to increase the compensation to operators for adding a channel to a regulated tier of cable service. Specifically, the FCC should permit operators adding a new channel to recover the out-of-pocket license fee and a flat fee. While various flat fee proposals have been suggested,[4] Discovery believes that the flat fee should be great enough to restore incentives for adding low-cost networks while also protecting subscriber interests. Absent such a flat fee, operators will lose the incentives to bring subscribers appealing low-cost programming. At the same time, Discovery believes that there is no reason to grant a flat fee for a "pay-per-view" or shopping channel as these services already generate significant revenues for cable operators.

To safeguard important subscriber interests, the Commission should condition the operation of the flat fee in several respects. First, in order to preserve viewer options, the mark-up should apply only when the public receives an additional channel on a regulated tier. Discovery urges the Commission to establish a "floor" or base number of regulated channels that the operator must exceed before obtaining the benefit of the flat fee. Discovery suggests that the floor be set at the total number of regulated channels that the operator offered to the

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[4] For example, A&E/ESPN has proposed a flat fee based on a comparison of an operator's average product cost and the total tier price. Comments of A&E and ESPN in Support of Petitions for Reconsideration in MM Docket No. 92-266 (filed June 16, 1994) at 11-12. Similarly, Continental Cablevision has proposed an "average margin plan" that would allow operators a flat fee equal to the programming cost margins embedded in the benchmark rates. Response of Continental Cablevision, Inc. to Petitions for Reconsideration in MM Docket No. 92-266 (filed June 16, 1994) at 10-12. Discovery would support either of these approaches.

public on January 1, 1994. Hence, an operator with a base number of 35 regulated channels who later removes 3 channels to create an a la carte package will first be eligible for the fee at such a time as a fourth new channel -- channel number 36 -- is added to regulated tier. In the absence of such a rule, operators could earn the fee with channel "switch outs" or substitutions, whether accomplished in a day, or over several months time. Such a scenario would create artificial incentives to remove existing programming from regulated tiers to the detriment of subscribers and programmers alike by creating weaker, highly-penetrated regulated tiers. This limitation would ensure that the viewing public pays higher rates only when regulated cable service is expanded.

Second, if the Commission is concerned about the impact of a flat fee on subscriber rates, it could adopt an annual cap on increases in retail prices to cable subscribers caused by the addition of networks. A reasonable annual cap of $1.50 on the amount of license fees and flat fees that an operator could pass through would successfully balance the interests of operators, programmers and subscribers. Moreover, compelling grounds would exist for a narrow exception to such a limit where an operator, pursuant to a system rebuild, is able to place an unusually large number of channels into regulated service in one year. In such instances, the public interest is served by allowing operators to pass through the new fees.

In conjunction with such a fee for new program services, Discovery also urges the FCC to increase the mark-up on incremental programming expenses for currently carried cable networks. The continued growth of programming entails not only the launch of new networks, but also maintaining and improving the quality of material carried on established

networks like The Discovery Channel. Indeed, The Discovery Channel cannot economically acquire and produce new and resource-intensive original material if operators are strongly disinclined to support such investments in quality.

The Commission's goal of providing "sufficient incentives for cable operators to invest in continued growth of cable television service" is plainly thwarted by a mere 7.5% mark-up of such expenses.[5] By the Commission's own standards, a 7.5% mark-up is unreasonable. In the cost-of-service proceeding, the Commission selected 11.25% as a reasonable rate of return on cable service.[6] This rate of return pales in comparison to other entertainment business returns, which are in the range of 25 percent. Moreover, there is absolutely no basis to cap the rate of return on programming at a level even below that insufficient return. In Discovery's view, the FCC has it backwards: the heart and soul of cable service -- and the product that has driven the success of the industry and satisfied consumers -- is the underlying cable programming. Thus, in the scheme of the rate regulations, the return to operators on investment in programming should be in excess of the return on such items as cable plant. A return on programming greater than that allowed for other elements of regulated service would better replicate the pre-regulation incentives that produced a wealth of quality programming unimaginable ten years ago. Without the prospect of an enticing -- much less a merely adequate -- return, operators will not undertake the

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[5] First Order on Reconsideration, 9 FCC Rcd at 1242.

[6] Report and Order and Further Notice of Proposed Rulemaking in MM Docket No. 93-215, FCC 94-49 (released March 30, 1994).

considerable risk of supporting high-quality programming, especially when investment in ancillary elements of cable service is, in essence, guaranteed to return a greater sum. Hence, Discovery respectfully submits that the FCC should increase dramatically the mark-up on new programming expenses.

III. THE PUBLIC INTEREST IN THE AVAILABILITY OF LOW-PRICED, HIGH-QUALITY, ADVERTISER-SUPPORTED CABLE NETWORKS DEPENDS ON CONTINUED CARRIAGE OF THESE NETWORKS ON REGULATED TIERS

Discovery generally supports the NCTA's position on operators' a la carte practices. As Discovery understands it, this approach would allow operators to migrate a set number of channels from a regulated tier without facing regulatory scrutiny. This would strike a proper balance between operators need for flexibility and the public interest in maintaining the availability of low-priced, high-quality, advertiser-supported networks.[7]

Discovery also supports the adoption of guidelines allowing operators safely to migrate a la carte channels back to a regulated tier without fear of violating the negative option rule or incurring liability of any kind. Such guidelines would be of benefit to operators, programmers and subscribers. Operators who restructured their service offerings in reliance on the initial general a la carte conditions set forth in the First Report and Order[8] may now be judged differently under the more specific guidelines adopted in the Fourth

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[7] The operator's incentive to a la carte is far less with sufficient incentives, including a flat fee.

[8] May 1993 Rate Order, 8 FCC Rcd 5631, 5836-38 (1993).

Report.[9] "reverse migration" guidelines would allow these operators to conform their service structure to the current rules without liability. By encouraging operators to retier, moreover, advertiser-supported networks that have been removed to a la carte packages will regain their advertising revenue base and, in turn, their ability to provide subscribers with high-quality programming at a modest price. Accordingly, the public interest would be served by the adoption of reverse migration guidelines that are applicable nationwide.

IV. COMPLAINTS CONCERNING PASS-THROUGHS OF PROGRAMMING COSTS SHOULD NOT RE-OPEN EXISTING RATES NOT PREVIOUSLY FOUND TO BE IMPROPER

Discovery believes that where a subscriber files a complaint concerning a rate increase on the cable programming service tier, the scope of review should be limited to the specific rate increase and not the operator's existing rates. Current FCC rules provide that complaints regarding rates in existence as of the date of regulation of the cable programming services tier must be filed by February 28, 1994. See 47 C.F.R. § 76.953(a). After that date, complaints may be filed only if an operator changes its rates. Id. at 76.953(b). The Commission has interpreted subsection 76.953(b) as subjecting the operator's entire rate structure to review, even though the statutory deadline for reviewing the initial rate may have long since passed with no subscribers filing complaints. Rate Order, 8 FCC Rcd at 5866.

Therefore, an operator's pass-through of expenses associated with the addition of a new channel or a license fee increase could jeopardize the operator's presumptively final and

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[9] Second Order on Reconsideration at ¶ 191-200.

reasonable rates. Faced with the prospect of an unjustified rate proceeding and even rate reductions, a rational operator might decide not to incur additional program expenses, as the costs of doing so could substantially outweigh the benefits. Consequently, not only does the current rule deprive operators of a reasonable measure of finality for business planning purposes, it also hurts programmers and subscribers whose programming options may be frozen in place at a time when economic considerations justify the expansion of programming. The public interest will be better served if the Commission limits complaints filed in response to a programming expense pass-through to the amount of the resulting rate increase.

V. CONCLUSION

Consistent with the foregoing principals and proposals, Discovery respectfully requests that the Commission take action to ensure the continued growth of new and existing cable networks.

Respectfully submitted,

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